

GROWTH

INVESTMENT

Louisiana Department of the Treasury

<< Fiscal Year 2004 >>



PREPARED BY:

John Kennedy, State Treasurer

TREASURER'S LETTER

To the Honorable Kathleen Babineaux Blanco, Governor of Louisiana, The Members of the Legislature, and The People of Louisiana:



It is our job at the Louisiana Department of the Treasury to manage state investments to earn the best rate of return possible for Louisiana

taxpayers. The Treasury also oversees the state's bank accounts to ensure timely disbursements to state agencies, on-time payments of state bills, and most importantly, the responsible management of taxpayers' hard-earned money.

Our *Annual Summary on the Financial Condition of the State* for Fiscal Year 2003–2004 (FY2004) showcases our work to obtain these goals, and some of the year's highlights include:

- Managing the state's cash flow, which exceeded \$20 billion.
- Collecting a record \$36.8 million in unclaimed property from Louisiana businesses and refunding \$11.9 million to Louisiana residents.
- Working with the Office of Student Financial Assistance to expand the START Program to 15,721 accounts and \$63.3 million in total assets for the calendar year ending December 31, 2004.
- Generating \$225.9 million in investment income for the state including \$139.9 million for the state's major trust funds and \$85.9 million for the General Fund.

- Earning a 3.9 percent cash basis rate of return for the Millennium Trust Fund, a 4.5 percent cash basis rate of return for the Medicaid Trust Fund and a 7.1 percent total rate of return for the Louisiana Education Quality Trust Fund (LEQTF).

- Approving through the State Bond Commission more than 150 bond issues and refinancings for local governments, political subdivisions, public trusts, non-profits and industrial development boards, the proceeds of which were used to build and improve infrastructure and to grow jobs.

- Topping \$1 billion in investments in the LEQTF for the first time in the fund's history.

- Selling \$175 million in Certificates of Deposit (CDs) using BidLouisiana, a competitive online auction system.

- Investing in foreign bonds for the first time in the state's history, the first \$5 million of which we invested in the State of Israel.

I look forward to continue working with you, and together we can build on these successes for the benefit of Louisiana citizens.

John Kennedy
State Treasurer

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ABOUT THE ANNUAL REPORT

Each year, we email the *Annual Summary on the Financial Condition of the State* to the governor and members of the Legislature before the start of the regular legislative session. The general public can view and download this publication at www.latreasury.com.

For this year's report, we provide a detailed description of our annual investment figures, performance and programs for FY 2004 (which ended June 30, 2004) and any relevant events up to the Spring 2005 publishing date. We also explain the role of the Treasury and what services we offer to the taxpayers of the state of Louisiana.



Photo courtesy of the Louisiana Department of Culture, Recreation and Tourism.

OUR MISSION

The mission of the Department of the Treasury is to manage state funds by promoting prudent cash management and investment strategies as well as monitoring, regulating and coordinating state and local debt obligations as mandated by the Constitution and the laws of the state of Louisiana.

ABOUT THE TREASURER

John Kennedy—State Treasurer

John Neely Kennedy was elected without opposition to his second term as State Treasurer on October 4, 2003. He was first elected Treasurer in 1999 when he unseated the incumbent with 56 percent of the vote.

Kennedy manages the state's \$5 billion bank account including the investment of \$3 billion in trust funds. He oversees all local and state bond issues, returns millions of dollars in unclaimed property each year, and takes care of state fiscal matters.

Prior to his position as Treasurer, Kennedy served as Secretary of the Louisiana Department of Revenue from 1996-1999. As Secretary, he was responsible for returning more than \$22 million in unclaimed property to over 50,000 Louisiana citizens. He also made tax time easier for all Louisiana citizens by reducing the number of sales tax returns small businesses must file and by returning state tax refunds faster than ever before.

Kennedy's public service includes Special Counsel to Governor Buddy Roemer from 1988-1992 and Secretary to the Governor's cabinet from 1990-1992. He was a member of Governor Roemer's Commission on Medical Malpractice and the Secretary of State's Commission on Corporations.

His private sector work includes a civil litigation practice as an attorney and partner in the Baton Rouge and New Orleans law firm of Chaffe, McCall, Phillips, Toler and Sarpy, L.L.P. He received his Juris Doctorate in 1977 from the University of Virginia, where he was executive editor of the *Virginia Law Review* and inducted into the Order of the Coif. He is a first class honors graduate of Oxford University, where he received a B.C.L. degree in 1979.

Kennedy completed his undergraduate studies at Vanderbilt University where he was president of his senior class, elected to Phi Beta Kappa, and graduated magna cum laude in political science, philosophy and economics. He is a native of Zachary, Louisiana, and is an alumnus of Zachary High School, where he earned co-valedictorian honors in 1969.

The Treasurer serves on 29 state and national boards and commissions, including five state retirement systems, the Interim Emergency Board, the Louisiana Tax Free Shopping Commission, the Louisiana Tuition Trust Authority, the Louisiana Housing Finance Agency, and the Louisiana Lottery Corporation. He is president of the Louisiana Asset Management Pool, chairman of the Old State Capitol Advisory Board and a member of the board of directors of the Louisiana Workers' Compensation Corporation. He is a past member of the board of directors of the Council for a Better Louisiana and the board of directors of the Institute for the New Orleans Center for Creative Arts.

Kennedy has published articles in the *Louisiana Law Review*, the *Tulane Law Review*, the *Louisiana Bar Journal* and the *Akron Law Review*.

He resides in Madisonville, Louisiana, with his wife, Rebecca Ann Stulb Kennedy, who is also an attorney and special magistrate, and their son, Preston, who is nine years old. They are members of the North Cross United Methodist Church.

THE LOUISIANA TREASURY

BANKING & INVESTMENTS

RECEIPTS (MONEY IN)

EXAMPLES:

- State Tax Dollars
- Fees
- Federal Dollars



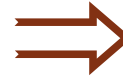
\$ TO TREASURY



THE TREASURY PERFORMS THE FOLLOWING ROLES:

- 1. Banking**—checking and savings accounts for the state of Louisiana and its agencies.
- 2. Accounting**—allocating money and earnings to one of 300+ special funds.
- 3. Investment Management**—buying bonds and stocks to earn interest dollars on money saved or kept in the Treasury.

THE TREASURY IS JUST LIKE THE STATE'S OWN BANK, PLUS A FEW EXTRA SERVICES! WE SAFEGUARD DEPOSITS AND EARN INTEREST WHILE THE MONEY IS WITH US AND TRACK THE DAILY FLOW OF CASH.



\$ FROM TREASURY

DISBURSEMENTS (MONEY OUT)

EXAMPLES:

- State agency operation & payroll
- Payment of vendors
- Providing public services (healthcare, law enforcement)

BOND COMMISSION (FUNDRAISING)



THE BOND COMMISSION RAISES CAPITAL FOR PUBLIC PROJECTS BY ISSUING DEBT IN THE FORM OF STATE BONDS.

FACTS ABOUT THE TREASURY:

- Treasury managed an average of \$5.6 billion in monies in our investment portfolio in FY 2004.
- Treasury's General Fund investment portfolio's cumulative income exceeded the \$3.2 billion mark by June 2004.
- Treasury is the smallest staffed state agency with 56 employees.
- Treasury managed over 337 statutory and constitutionally created funds in 32 separate investment portfolios earning \$225.9 million in FY 2004.
- Treasury utilizes a central cash management pooling concept to gain the maximum investment of monies through the centralized pooling of deposits, Treasury processed over 4.2 million deposit items and 73,000 credits in FY 2004 totaling over \$20.7 billion.
- Treasury managed 14 General Obligation debt issues with debt service of over \$271 million in FY 2004.

UCP (LOST & FOUND)



THE UCP DIVISION FINDS LOST OR FORGOTTEN MONEY BELONGING TO LOUISIANA CITIZENS & BUSINESSES AND WORKS TO RETURN THE MONEY TO ITS OWNERS.

UNCLAIMED PROPERTY (UCP)

The Treasury's UCP Division is responsible for finding owners of unclaimed, intangible personal property that has been turned over to the state. This includes payroll checks, checking and savings accounts, royalties, utility deposits, interest, dividends, stock certificates and life insurance proceeds.

One in six people in Louisiana has unclaimed property listed with the state, and the average refund is \$200 to \$300, although some amounts are in the several thousands. There is no fee for collecting unclaimed property through the Treasury, and there is no expiration date for making a claim.

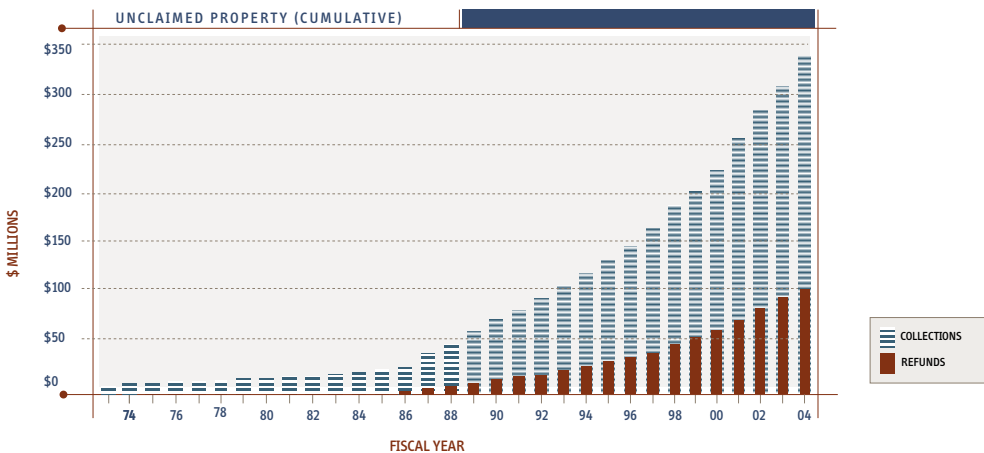
With the support and assistance of the Louisiana Legislature, and because of continued efforts to increase the public's awareness about the program, the state has returned over \$103.8 million since the unclaimed property law was passed in 1972.

In FY 2004, the Treasury collected a record \$36.8 million in unclaimed property from businesses and refunded \$11.9 million to rightful owners. Louisiana's program is recognized as one of the best in the nation and has been featured twice on national television.

The UCP Division continues to operate its toll-free number nationwide, and citizens across the United States can see if the state is holding their money by calling 1-888-925-4127. The Division's user-friendly website features an online claim feature that has generated more than 15,566 claims totaling \$8.7 million since its inception. In addition, the website received and processed over 2.6 million online searches for FY 2004.

In addition, Treasury joined with other states to begin participating in "MissingMoney.com," a state-sponsored website that maintains a national database of state unclaimed property records. Treasury also added French and Spanish language options for the unclaimed property owner name search on www.latreasury.com.

On the compliance side, holder education seminars were held in major cities across Louisiana to inform companies of their obligations to report unclaimed property, and an in-state auditing program was initiated to ensure that companies were complying with the unclaimed property law.



GENERAL INVESTMENT CLIMATE

The recession of 2001 and the weak recovery that ensued thereafter forced the Federal Reserve (Fed) to lower interest rates to levels not seen in 40 years. Barring a major negative shock to the economy, interest rates are now likely headed upward for perhaps the next several years. The economic recovery that began in late 2001 has within the past year become considerably stronger and more balanced.

Real Gross Domestic Product (GDP) grew during 2003 at 3.0 percent on an annual basis. During 2004, GDP was at a 4.5 percent annual growth rate. For 2005, available economic data suggest that slowing may be in process. Nothing in the recent economic data suggests that the current economic expansion, although slowing, is in danger of faltering. Consumer confidence remains high, and the growth of personal income continues. Housing activity continues to forge ahead. Business capital spending is being bolstered by rising corporate profits, increased output, replacement of obsolete high-tech equipment, and the desire to improve productivity and hold down costs.

Today, the United States is running a government deficit of about 3.5 percent of GDP. Its trade deficit is about 5.5 percent of GDP. The dollar has weakened under the accumulating international

ownership of American assets. However, the cost of acquiring funds has hardly increased. Inflation adjusted interest rates on the 10-year government bond are higher than historical norms, but the 2.5 percent real interest rate against the core inflation rate is far below those experienced in the 1980s.

In response to indications of modest economic growth, the Fed began raising the key federal funds rate by 25 basis points at its Federal Open Market Committee policy meeting on June 30, 2004. It was the first increase in the funds rate since May 2000. The Fed has raised rates by 25 basis points at every FOMC policy meeting since.

Increasing economic activity and rising interest rates are a mixed blessing for Treasury investments. Increasing interest rates translate to the opportunity for stronger interest income over time. However, rising interest rates also lead to weaker total return figures for the Treasury's investment portfolios because of lower market value.

BUDGET AND STATE SPENDING

The state’s revenue picture has continued to improve in FY 2004. This is reflected in the *Louisiana Comprehensive Annual Report for the Fiscal Year Ended June 30, 2004* (CAFR) by the net increase in tax revenues of \$427 million and an increase of \$489 million in federal grants and other revenue sources.

For the second year in a row, funding from grants and other contributions exceeded income from taxes. However, collections from both income and sales taxes (the two largest single contributors to state tax revenues) improved by \$626 million when compared to the previous fiscal year.

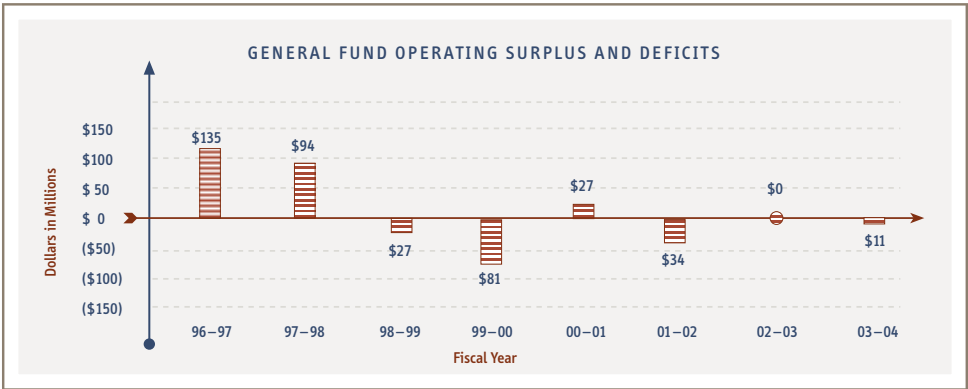
Gaming revenues from video draw poker devices, riverboats and other gaming sources reflected the lowest increase in the past five fiscal years in the amount of \$18.9 million.

Non-taxable income derived from the Treasury’s investments program contributed \$51.0 million to the State General Fund. This reflects a cash rate of return of 3.0 percent in a short-term investment portfolio when compared to the

benchmark 30-day Treasury Bill total rate of 0.9 percent during the same time period. This is the third consecutive year investment earnings have exceeded official revenue projections.

On the expenditure side, state expenditures in FY 2004 were \$17.9 billion as compared to Fiscal Year 2003 of \$17.2 billion. Expenditures increased in most areas of services to citizens, but most notably in the areas of education and health care.

The graph below, “General Fund Operating Surplus and Deficits”, reflects an \$11 million deficit at the end of FY 2004, which means that the state’s overall obligations were greater than its total financial resources.



Source: Louisiana Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2004.

CASH FLOW

The cash deposited into the General Fund and the cash disbursed from the General Fund vary month-to-month during the fiscal year. The Legislature has provided a way to ensure that the state pays its obligations timely during the months where the cash disbursed from the General Fund exceeds the cash deposited into the General Fund. This is called interfund borrowing. The General Fund temporarily borrows cash from a group of special funds in the Treasury. The total cash balance in these special funds is called the interfund borrowing base.

The “Interfund Borrowing Base” chart on page 10 depicts the total cash available for borrowing by the General Fund at the end of each month of the fiscal year. As depicted, the General Fund has a large pool of cash available each month to meet its cash borrowing needs.

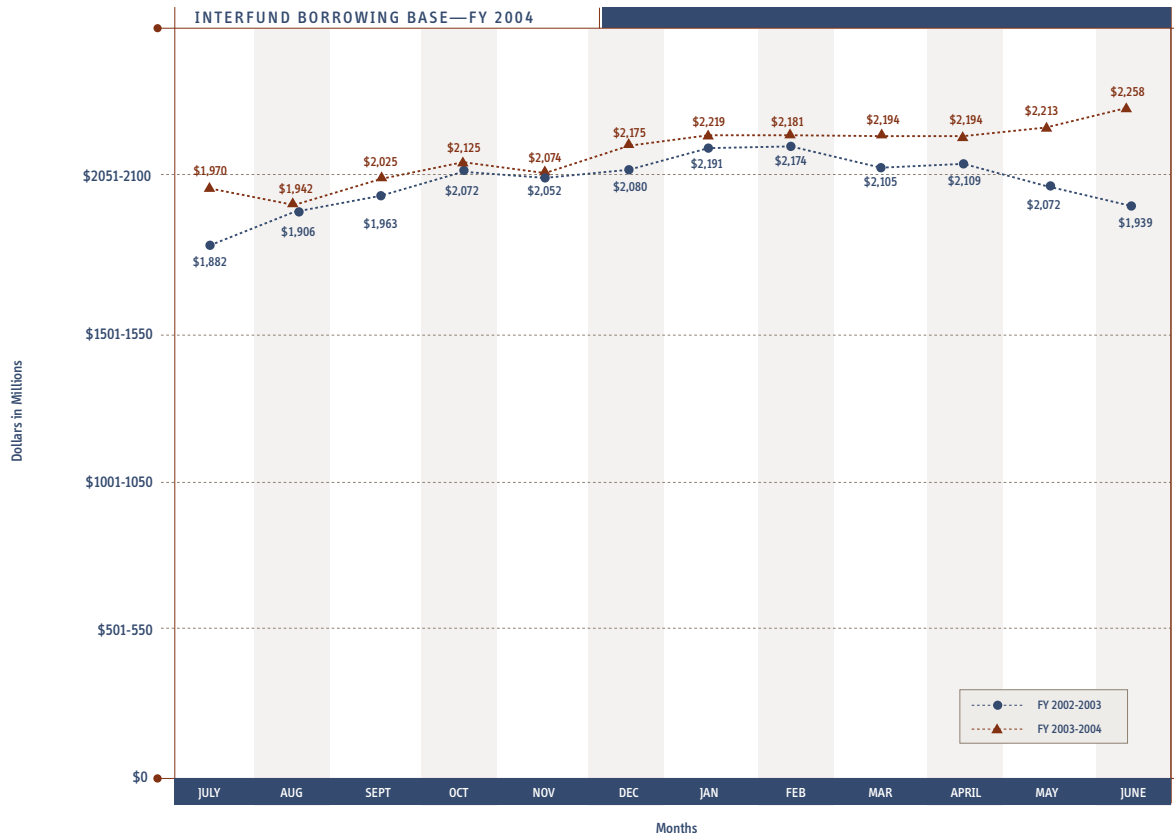
The “General Fund Month-End Balances – FY 2004” chart on page 11 depicts the cash balance of the General Fund at the end of each month. Points on the line graph below the \$0 line reflect the amount of cash borrowed by the General Fund at the end of the month. Points above the \$0 line reflect that the General Fund has a cash balance; thus, no interfund borrowing is required at the end of that month.

The legislation authorizing interfund borrowing requires that all borrowing be repaid by the close of the fiscal year. This requirement ensures that the General Fund does not spend money it will not collect in that fiscal year.

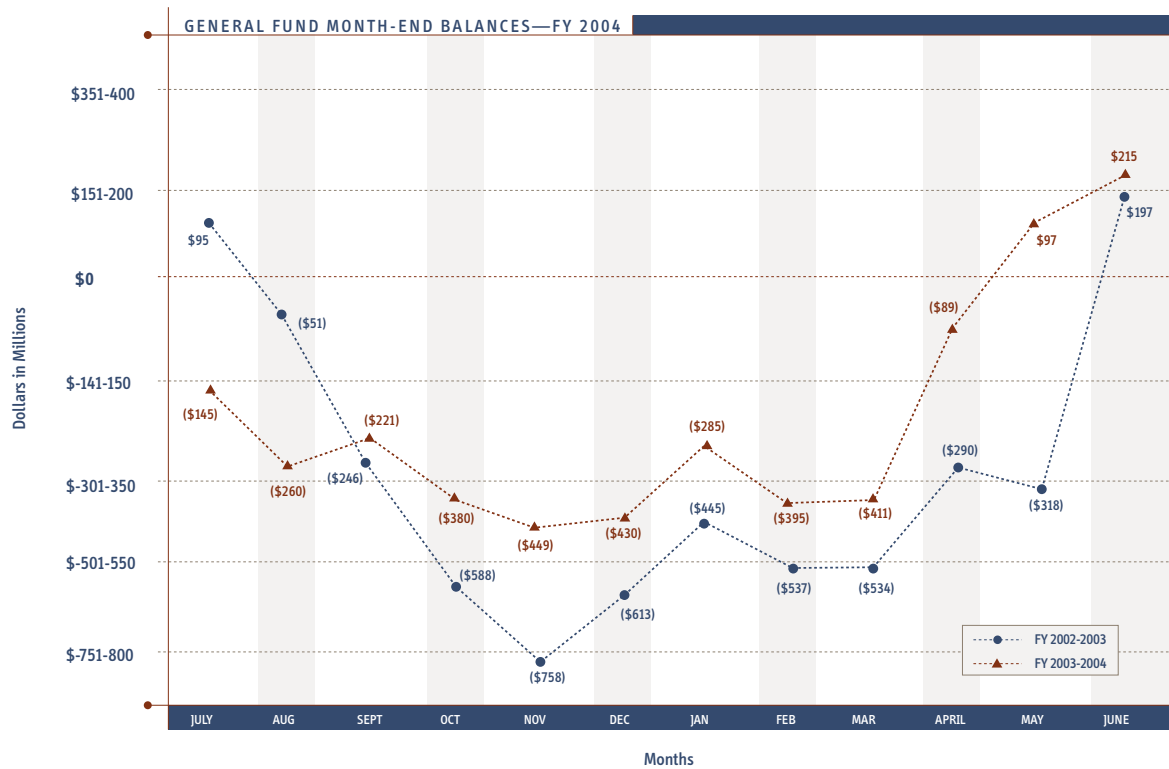
The chart reflects that all interfund borrowing that occurred during FY 2004 was repaid by June 30, 2004—the close of the fiscal year.

The graphs on pages 10 and 11 titled “Interfund Borrowing Base – FY 2004” and “General Fund Month End Balances – FY 2004” reflect the overall better average cash position of the General Fund in FY 2004 as compared to FY 2003. This improvement is based on an increase in revenues of over \$350 million and the timing of expenditures in FY 2004. At the end of FY 2004, even though the graph on the preceeding page indicated an overall negative balance, the General Fund cash position was a positive \$215 million reflecting full repayment of all interfund borrowing as required by state law.

The Treasury monitors the state’s cash position on a daily basis. The information gained from this monitoring is linked to the state’s investments program, which assists the Treasury in gaining the highest available rate of return on its cash resources.



Amounts represent the actual base at month-end before interfund borrowing.
Source: Advantage Financial System (AFS), the state's centralized accounting system.



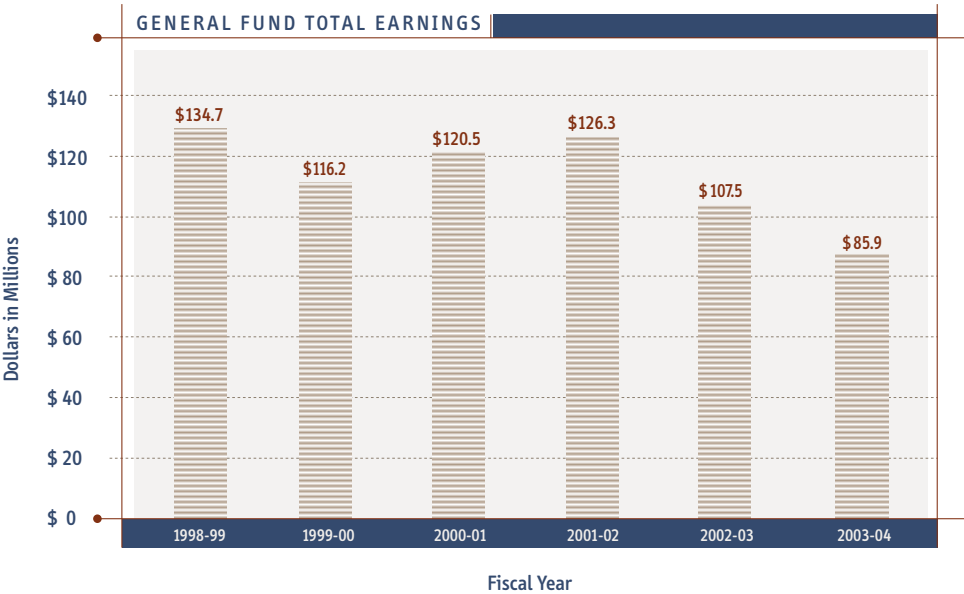
Source: Advantage Financial System (AFS), the state's centralized accounting system.

INVESTMENTS

General Fund

The state’s General Fund averaged \$2.0 billion in invested funds in FY 2004, providing \$85.9 million in earnings, and had a cash basis rate of return of 3.0 percent. The General Fund is the state’s main transaction account and the hub of the state’s cash management program. Made up of combined and segregated portfolios, the General Fund is the

mechanism for managing fixed income investments that benefit programs such as the state’s Artificial Reef, Education Excellence and START funds.



Source: Advantage Financial System (AFS), the state’s centralized accounting system.

INVESTMENTS

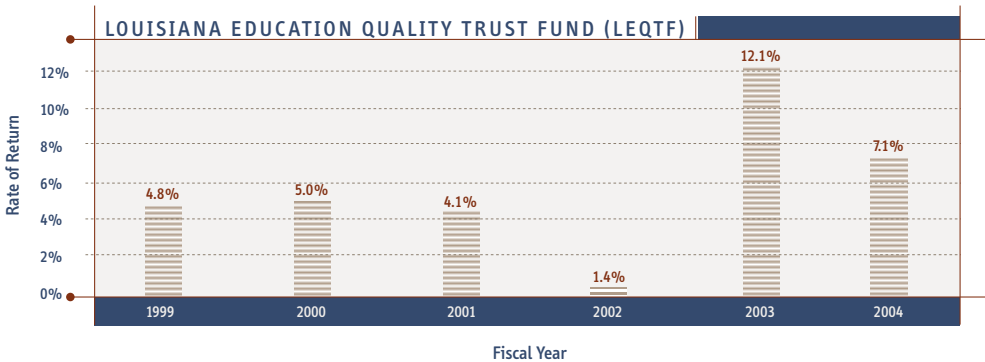
Louisiana Education Quality Trust Fund (LEQTF)

The fixed-income and equity investments of the Louisiana Education Quality Trust Fund (LEQTF) earned a 7.1 percent total rate of return in FY 2004. Total return is a time-weighted measure of actual income received during the year, plus accrued income and any change in the price of portfolio securities and cash at the end of each year.

Act 802 of the 1990 Regular Session of the Legislature requires that the investment earnings of the LEQTF be measured against the two-year U.S. Treasury Note and the 30-day U.S. Treasury Bill. For FY 2004, the LEQTF easily outperformed

its legislative benchmarks, and earned \$88.2 million in income including interest, dividends, securities lending and royalty income. LEQTF provided \$64.7 million in additional funding for classroom computers, teacher training, matching grants and research.

With a market value of over \$1.0 billion, LEQTF has generated almost \$959 million for higher education since its inception in 1986, making it a stable source of revenue for a variety of educational enhancements and opportunities for Louisiana students at every level of education.



Source: LEQTF Annual Report, June 30, 2004.

INVESTMENTS

Medicaid Trust Fund for the Elderly

For FY 2004, the Medicaid Trust Fund earned \$46.8 million in income and had a cash basis rate of return of 4.5 percent. The market value of the fund was \$881.5 million for FY 2004 compared to \$909.2 million in FY 2003. The trust fund transferred out \$46.2 million in investment earnings and principal to fund elderly healthcare and nursing home expenses.

The Medicaid Trust Fund was established in 2000 and was funded by intergovernmental transfers from the U.S. government and the state. The trust benefits the State Department of Health and Hospital's Medicare program in Medicare-certified nursing homes and Medicare programs subject to federal financial participation in matching funds.

Millennium Trust Fund

For FY 2004, the Millennium Trust fund's market value increased from \$1.1 billion to \$1.2 billion. Income earned on the fund totaled \$40.1 million this fiscal year, and the fund's cash basis rate of return was 3.9 percent. The Treasury created the Millennium Trust in 2001 when the state sold 60 percent of its tobacco settlement revenue stream and dedicated the proceeds to healthcare, education and the TOPS scholarship program.

Rainy Day Fund

The Rainy Day Fund (Budget Stabilization Fund), approved by the voters as a 1998 constitutional amendment, provides for creating a savings account to meet future emergency funding needs. The cash balance in the Rainy Day Fund at the beginning of FY 2004 was \$191.1 million, and it grew by \$45.8 million over the course of the fiscal year. This growth came from two sources—\$5.8 million of the Revenue Estimating Conference fiscal year end 2003 non-recurring surplus (25 percent) and \$38.7 million in mineral income over the \$850.0 million base.

The objective is to grow the Rainy Day Fund to provide a means to stabilize recurring revenues each fiscal year to avoid budget cuts that adversely affect government services to the citizens of the state.

No monies were expended from the Fund in FY 2004. The cash balance in the Rainy Day Fund at the end of FY 2004 was \$239.3 million.

SOCIAL SECURITY

The Treasury's Social Security Division is responsible for administering the Section 218 Social Security and Medicare coverage program for all public governmental employers throughout the state of Louisiana. The Division serves as a facilitator between employers and the U.S. Social Security Administration (SSA) and Internal Revenue Service (IRS).

Beginning in 1951, Section 218 of the Social Security Act authorized states to voluntarily elect Social Security coverage for certain public employees who were not already covered under a retirement plan. These federal-state agreements, often referred to as Section 218 agreements, were entered into with the Social Security Administration.

Treasurer Kennedy is an advocate for preserving public employee retirement plans, especially for those who are not covered under Social Security. Mandating public systems to participate in Social Security when they choose not to would jeopardize the financial stability of the systems and would adversely impact the benefits that the participants receive.

GPO and WEP

If a public employee who is covered under an independent public retirement plan has paid into Social Security at some point in his or her life, there are currently two provisions in Social Security that adversely affect the receipt of benefits. The first is called the Windfall Elimination Program (WEP), which reduces Social Security benefits for people who have spent most of their careers in government but who have also worked in private industry. The other provision is called the Government Pension Offset (GPO), which reduces—and in some cases eliminates—the Social Security benefit due to a government employee as a spouse. Treasurer Kennedy supports

any federal legislation that would eliminate or reduce the detrimental effects of the GPO and the WEP on retirees in Louisiana.

Social Security benefits statements do not calculate the GPO or WEP, and this leads government retirees to have higher pension expectations than they should.

Referenda

Federal legislation supported by Treasurer Kennedy added Louisiana to the list of states that can conduct divided referenda for Medicare and/or Social Security coverage under Section 218 of the Social Security Act. The state passed enabling legislation to offer this option to state and local governmental employees in Louisiana.

A divided referendum helps individual Louisiana public employees as well as their state and local government employers by providing an opportunity for "Medicare-Only" coverage for employees hired prior to April 1, 1986. The divided referendum enables employees who vote "yes" to pay Medicare and employees who vote "no" to not pay Medicare.

It is estimated that Louisiana could save millions of dollars by using divided referenda, when Medicare is primary and an employer's health insurance is secondary. The Treasury's Division of Social Security is responsible for conducting each referendum at the request of the employer or the retirement system. As of March 2005, a total of 68 Medicare-Only referenda have been scheduled at 31 local government agencies in Louisiana allowing approximately 13,000 government workers the option of paying the Medicare tax. These figures include all the state universities and 16 parish school boards.

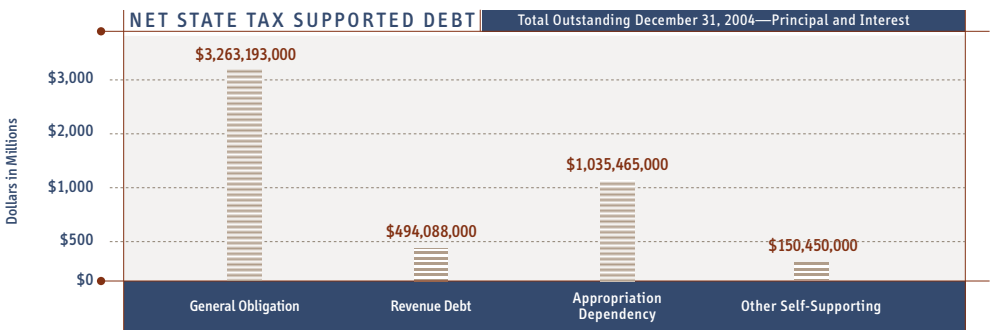
For more information, visit www.latreasury.com, and go to the Social Security Division page.

STATE CREDIT RATING AND DEBT

All three bond rating agencies maintained the state's bond rating in 2004. Fitch assigned a rating of "A+" which reflected the institutionalization of structural changes that strengthen the state's credit, as well as debt reduction in recent years and increased efforts at economic development. Moody's assigned a rating of "A1" and stable outlook, citing the state's positive fiscal position during a period when many states' finances have been negatively affected, conservative budget and debt management, recent tax reforms, and a strong

cash position. Standard and Poor's assigned a rating of "A+" based upon improved financial and budgetary performance, prudent use of the Rainy Day Fund, economic development initiatives, and a decline in debt burden.

The following chart illustrates the categories included in the definition of Net State Tax Supported Debt, and the various types of debt included in each category.



Notes for Chart:

General Obligation includes General Obligation Bonds.

Revenue Debt includes Gasoline & Fuels Tax Revenue Bonds Series 2002A—payable from the proceeds of a four-cent per gallon gasoline tax.

Appropriation Dependency Debt includes Office Facilities Corporation; LPFA Hotel Dieu, 2002; Louisiana Correctional Facilities Corporation, 2002; LPFA Public Safety JESTC, 2001; LPFA Public Safety Fire Marshal's Headquarters, 2002; LCDA Bossier Parish Community College; LCDA Baton Rouge Community College; South Louisiana Community College.

Other Self-Supporting Debt includes Crescent City Connection, Greater Baton Rouge Port Commission and Greater New Orleans Expressway Commission.

Source: Unaudited data from the Division of Administration.

STATE CREDIT RATING AND DEBT

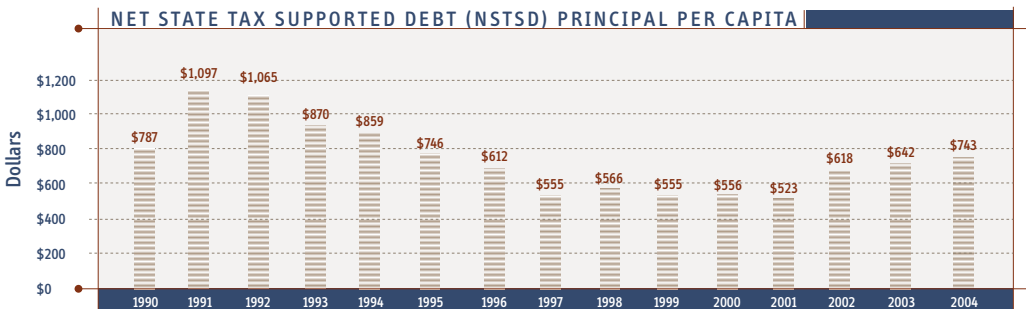
During FY 03-04, the state did not sell any bonds. However, in October of 2004, the state sold \$500 million in General Obligation Bonds to finance capital outlay projects for various purposes including general government; elected officials; economic development; culture, recreation and tourism; transportation and development; corrections and public safety; health and hospitals; natural resources; wildlife and fisheries; education; judiciary and non-state entities. These bonds were sold competitively via the Internet at an overall cost of 3.974 percent.

Although no General Obligation Bond sale is anticipated in calendar year 2005, the state did refinance \$650 million in General Obligation

Bonds in January of 2005 to take advantage of low interest rates and save \$27.7 million over the life of the bonds. When the state refinances a General Obligation Bond issue, it essentially pays off high-interest debt by selling new bonds at a lower interest rate.

Sometime in calendar year 2005, the state anticipates selling approximately \$500 million to \$525 million in Gasoline and Fuels Tax Revenue Bonds for utilization in the construction of various road and bridge improvement projects included in the Transportation Infrastructure Model for Economic Development (TIMED) program.

The following chart depicts the amount of Net State Tax Supported Debt (NSTSD) Per Capita for calendar years 1990-2004:



ONGOING INITIATIVES

Tobacco Settlement Sale

- Treasurer Kennedy will work with the Legislature and the governor to decide if the state should sell the remaining 40 percent of the state's tobacco settlement revenue stream. Based on the Original Master Tobacco Settlement Agreement payout to Louisiana, there is about \$1.5 billion (dollars not adjusted for inflation) in payments still remaining over the life of the settlement (through calendar year 2025). Louisiana citizens have voted for a constitutional amendment to dedicate a portion of a second tobacco sale to coastal erosion in the state.
- There are several factors that point to securitization as a viable option for the state, one of the biggest being pharmaceutical risk. The pharmaceutical industry is developing new and better drugs every day that help stop the addiction to smoking. Other factors include improvements in the tobacco bond market and a stable legal environment in the tobacco industry.

Substitute Teaching

- The Treasury worked with the Legislature in FY 2004 to pass a resolution encouraging legislators to volunteer as substitute teachers in public schools. Treasurer Kennedy continues to substitute teach for no pay in East Baton Rouge Parish public schools and encourages his colleagues to substitute teach as well.

Earned Income Tax Credit

- The Treasury continues to encourage working families in the state to claim the federal Earned Income Tax Credit (EITC). The EITC provides low-income workers with a rebate of all or a portion of the federal income taxes they pay each year. It is one of the most important tax

breaks available for hard-working families in the state.

Web-Based Services

The Treasury uses technology to work smarter, faster and better for Louisiana citizens. The agency completed a variety of projects in FY 2004 using information technology and web-based services. These include:

- Offering links on Treasury's homepage to the non-profit www.louisianagasprices.com for low gas prices, www.fuelgaugereport.com for nationwide comparisons of gas costs, and AAA's Gas Watcher's Guide for helpful gas-saving tips.
- Also offering links to Tomorrow's Money, identity theft prevention information and IRS undeliverable refund checks.

Other web-based initiatives the Treasury continues to participate in include:

- Working with the Governor and the Louisiana Office of Electronic Services to expand the Louisiana E-mail by adding the payment option of "electronic check" for funds owed to the state.
- Accepting credit cards to make it easier for citizens to pay for state services, reduce NSF checks to the state, improve customer service, and expand payment options to the Internet.

Ongoing Banking & Cash Management Initiatives

- The Treasury's Cash Management Review Division continues to review state agencies in an effort to learn ways state government can save money when providing basic services to citizens.
- Treasury is working with the Department of Public Safety to implement lockbox collection services to receive approximately

ONGOING INITIATIVES

720,000 checks per year. This initiative will reduce the department's manpower needs to process daily incoming mail and prepare and deposit checks. The Department of Health and Hospitals, the Department of Wildlife and Fisheries and the Office of Student Financial Assistance are already effectively utilizing lockbox services.

- Treasury continues to assist state agencies to modernize their banking processes by implementing Internet-based agency to bank communications. This communications link allows state agencies to initiate online stop pays, wire transfers, Automated Clearing House debits and credits, and obtain statement information in a secure and accessible environment.
- Treasury continues to assist state agencies to implement the latest fraud prevention measures to protect against fraudulent check writing and electronic theft. For example, "Positive Pay" provides the bank with check issue information so the bank can recognize fraudulent checks and "ACH Debit Block" prevents unauthorized debits to the state's accounts.

One example is the Division's efforts to work with the Louisiana Department of Revenue to implement the Payee Name Positive Pay electronic security measure. Positive Pay prevents unauthorized persons from debiting Treasury's bank accounts, and it catches 99 percent of check forgeries.

- Treasury is working with the Department of Public Safety in their efforts to convert to a new computer system by automating the accounting for more than 175 daily deposit tickets prepared by Motor Vehicle Offices throughout the state.
- Treasury is working with departments to implement online banking services which

will improve efficiency and provide greater access to their banking needs.

- Treasury is providing banking services to the Department of Insurance to allow conversion of checks received to electronic credits which will reduce NSF checks and improve cash availability for investment by Treasury.
- Treasury is working with the Department of Health and Hospitals to develop an easier way for eligible workers with disabilities to pay premiums for Medicaid health care coverage.

Successful Banking Initiatives In FY 2004

Treasury has assisted many state agencies in implementing electronic banking technologies that will improve their receipt and payment processes.

Examples include:

- Assisting the State Employees Group Benefits Program in implementing electronic banking procedures to collect premiums from retired rehires and surviving spouses who are working after retirement;
- Helping the Secretary of State's office to pay poll commissioners at each election via electronic credits to eliminate delays, lost mail and stolen checks;
- Implementing a banking procedure with the Department of Agriculture and Forestry to pay employees' travel reimbursement expenses by electronic credits to the employees' bank accounts in lieu of issuing and mailing checks;
- Working with the Office of Rural Development to accept credit cards for payment of seminar registration fees.

MUTUAL FUND SCANDALS

Even those jaded by the corporate and Wall Street scandals of the past few years probably found it hard not to be shocked by this year's revelations of preferential treatment and self-dealing in the once-conservative mutual fund industry. So far, mutual fund companies named in market-timing and late-trading scandals have paid more than \$2.6 billion in fines, restitution and fee reductions. Strong, Putnam, Janus, Pilgrim and Alliance Capital are all mutual fund management companies named in market-timing and late-trading scandals.

Scandals in the mutual fund industry have illuminated the inherent conflict of interest between fund managers and fund investors. Over time, the focus of mutual fund governance and control shifted from the directors and shareholders of mutual funds to the executives and owners of mutual fund management companies. These individuals seek good fund performance but may also seek personal gain. These scandals may ultimately prove a blessing for fund owners, but first the mutual fund industry must address its shortcomings.

Independent directors are crucial to the fund process, and many critics believe they have failed in their job to this point. If the majority of a fund's board of directors is independent, members should feel no strings tugging at them if they need to make tough choices regarding costs, fees, the portfolio manager, the investment advisor or the management company.

Before investing in a particular fund, the Treasury's Investments Division familiarizes itself with fund disclosures related to market-timing and mandatory redemption fees. To dig beyond fund disclosures to detect market timing, the Treasury compares a fund's current portfolio turnover rate to the fund's historic rate. Market-timing may cause a substantial increase in the turnover rate. Treasury always reviews a fund's prospectus before investing.

In addition, the Treasury has found the Internet to be an excellent and efficient source of information for public documents regarding a mutual fund charged in a scandal. Documents may discuss the fund's role, civil complaints filed by regulators or shareholders, criminal indictments, or settlement agreements entered by the fund.

Treasurer Kennedy is working with state trust funds that invest in mutual funds to make sure investors' interests are paramount. The Treasury reviews mutual fund proxy materials carefully to make sure the funds the state invests in are taking appropriate steps to align the fund's interest with those of the fund's shareholders.

STUDENT TUITION ASSISTANCE AND REVENUE TRUST (START)

START is the state's 529 plan that helps individuals save money for a child's expenses at any approved university, vocational-technical school or community college. The program is tax-free, and START investors can deduct up to \$2,400 in deposits per account per year from income reported on their state income tax returns. If account owners are unable to use the full \$2,400 deduction, they can carry forward unused portions to subsequent years.

The Treasury manages fixed income investments in START, which totaled \$44.4 million in calendar year 2004 including contributions and interest. The Vanguard Group manages equity investments in START, which totaled \$17.3 million in 2004.

The majority of START's portfolio (72 percent) is in the Principal Protection option, which contains fixed-income investments. This portion of the portfolio earned a rate of return of 4.7 percent for the calendar year. The remaining portion of

the START portfolio (28 percent) is in various options that all include investments in some equities. Depending on the option chosen, the rate of return ranged from 6.0 percent up to 12.6 percent for the calendar year.

START closed the year with a \$25.8 million increase in total assets and 4,176 more accounts than the previous year.

START/Babymint/Vanguard

START continues its relationship with BabyMint to automatically deposit cash rebates into the 529 plan when participants shop at selected retailers. This assists START account owners in reaching their college savings goals when they shop at any of the more than 700 merchants and 127,000 stores contained within the BabyMint retail network.

START's Investment Options Include:

Option 1: Age-Based Option

- Vanguard LifeStrategy Moderate Growth Portfolio (Age 0 – 5)
- Vanguard LifeStrategy Conservative Growth Portfolio (Age 6 – 10)
- Vanguard LifeStrategy Income Portfolio (Age 11 – 15)
- Louisiana Principal Protection Option (Age 16+)

Option 2: Louisiana Principal Protection Option

- 100% Louisiana Fixed-Return Portfolio

Option 3: Total Equity Option

- 100% Vanguard Total Stock Market Index Portfolio

Option 4: Balanced Option

- 50% Fixed Income Investments and 50% Stocks

Option 5: Equity-Plus Option

- 75% Stocks and 25% Fixed Income Investments

Option 6: Principal Preservation-Plus Option

- 75% Fixed Income Investments and 25% Stocks

More information is available by contacting the Treasury's Investments Division at (225) 342-0020 or by visiting Treasury's website.

BIDLLOUISIANA

This fiscal year, the Treasury worked with the Legislature to increase the amount of funds the state could competitively bid out for CD investment from 20 percent to 50 percent. Using an Internet auction system called BidLouisiana, the Treasury awards cash to banks with the highest bid in exchange for CDs.

By using BidLouisiana to competitively bid out state funds available for CD investment, the Treasury has received \$231,800 in additional earnings for the state this past fiscal year.

CDs are a win-win situation for both the state and

banks. The state invests in CDs because they are widely accepted fixed income investments that are relatively safe. Banks win because they get cash up front that they can lend out to individuals or use in other ways, ultimately for the benefit of the community where they're located.

The state continues to directly market to financial institutions to increase awareness of and participation in the program. Louisiana banks can access information on CDs by logging on to **www.bidlouisiana.com**.

LOUISIANA ASSET MANAGEMENT POOL (LAMP)

The Louisiana Asset Management Pool (LAMP) is a cooperative endeavor that combines the efficiency of private enterprise with the protection of public policy. LAMP is managed by LAMP, Inc., a non-profit corporation that allows local officials to pool public funds and benefit from money management dedicated to preservation of principal, daily liquidity and a competitive rate of return. Treasurer Kennedy serves as President of the LAMP, Inc. Board of Directors.

At the end of the fiscal year, LAMP had 513 participants and 1,600 active accounts. LAMP continues to earn a Standard & Poor's rating of AAA, the highest designation available.

For more information, visit LAMP's website at **www.lamppool.com**.

ECONOMIC EDUCATION

College Savings Month

The Treasury continues to work with the governor and the Office of Student Financial Assistance to dedicate the month of September as College Savings Month. This is part of an annual national effort to encourage citizens to take advantage of state 529 plans.

Jump\$tart Coalition for Personal Financial Literacy

Treasurer Kennedy continues to be an active member and supporter of the Jumpstart Coalition for Personal Financial Literacy. The coalition is made up of individuals from the private and public sectors who come together to support personal financial literacy for each child in Louisiana.

The coalition was successful in passing legislation that requires Louisiana public high school students to take personal financial literacy courses as part of the Free Enterprise curriculum, and the first classes officially started in the fall of 2004.

Bank at School

Bank at School is a cooperative effort between the Treasury and the Louisiana Young Bankers Association. The program encourages elementary school students to open savings accounts at school with a minimum deposit of 50 cents.

Once the Treasury and elementary schools open banks at schools, teachers give monthly lessons on money management. Throughout the school year, the Treasury staff participates in as many Bank at School grand opening ceremonies as possible.

CONCLUSION

I look forward to continuing to work with the governor and the Legislature to further improve the state's finances, investment performance and credit rating. Businesses and investors are taking note that Louisiana is moving in the right direction and becoming more financially responsible. It is our job to continue to build on our successes to benefit all Louisiana citizens.

As always, it is a pleasure serving you.

John Kennedy
State Treasurer

* For information about the Treasury that may not be included in this report, please visit www.latreasury.com, or call my office at (225) 342-0010.



The Louisiana Department of the Treasury recognizes the importance of protecting Louisiana's coastline and wetlands, and it supports the America's Wetland campaign.

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